



## **Legislative Fiscal Bureau**

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May 11, 2009

Senator Mark Miller, Senate Chair  
Representative Mark Pocan, Assembly Chair  
Joint Committee on Finance  
State Capitol  
Madison, WI 53702

Dear Senator Miller and Representative Pocan:

Last January, this office prepared estimates of general fund tax collections for 2008-09 and the two years of the 2009-11 biennium. These figures, with modifications to reflect the April 1 increases in the federal excise taxes on tobacco and the provisions of 2009 Wisconsin Act 2, were incorporated into the Governor's 2009-11 biennial budget bill.

Recently, tax collections data for April became available and the May, 2009, national economic forecast was released by IHS Global Insight, Inc. (Global Insight). Prior to April, actual collections, in the aggregate, were tracking closely with the estimates. Weakness was evident in the corporate income and franchise tax, but this was offset by better than anticipated sales tax receipts. However, the April collection report shows a decrease of 35.8% (-\$317 million) in monthly individual income tax revenues compared to last April. Year-to-date income tax collections are now 8.3% below last year's level, compared to -2.7% through March. Similar decreases have occurred at the federal level and in a number of other states.

After the January tax revenue estimates were released, measures of economic activity in the fourth quarter of 2008 were revised downward significantly. Global Insight issued new economic forecasts in February and March that were considerably more pessimistic than the January forecast. The April and May forecasts were somewhat more positive, but are still significantly below the January projections.

Based on our review of tax collections data and the new economic forecast, we now believe that general fund tax revenues will be lower than the previous estimates by \$408 million in 2008-09, \$573 million in 2009-10, and \$622 million in 2010-11. The three-year reduction is \$1,603 million, or approximately -4.3%.

Most of the net decrease is due to the individual income tax and corporate income and franchise tax. Estimated revenues from the general sales and use tax have been increased considerably, and smaller adjustments have been made to some of the other tax sources.

Table 1 shows the revised tax revenue estimates and Table 2 outlines the May, 2009, economic forecast by Global Insight. The tax revenue estimates in Table 1 reflect current law (including Act 2), but do not incorporate any of the tax law changes recommended by the Governor in the budget bill. The sections following the tables present additional information about the economic forecast and the new revenue estimates.

**TABLE 1**  
**Projected General Fund Tax Collections**  
**Current Law Through 2009 Act 2**  
**(\$ in Millions)**

	<u>2007-09 Biennium</u>		<u>2009-11 Biennium</u>	
	<u>2007-08</u> <u>Actual</u>	<u>2008-09</u> <u>Estimated</u>	<u>2009-10</u> <u>Estimated</u>	<u>2010-11</u> <u>Estimated</u>
Individual Income	\$6,713.7	\$6,185.0	\$5,870.0	\$6,080.0
General Sales and Use	4,268.1	4,130.0	4,055.0	4,280.0
Corporate Income and Franchise	837.8	615.0	650.0	740.0
Public Utility	297.5	320.7	318.2	327.4
Excise				
Cigarette	455.7	558.8	534.8	529.5
Tobacco Products	45.2	44.0	45.8	47.6
Liquor and Wine	29.8	41.0	40.1	40.6
Beer	9.6	10.0	10.0	10.0
Insurance Company	156.6	140.0	148.0	148.0
Estate	158.8	21.0	0.0	0.0
Miscellaneous Taxes	<u>70.3</u>	<u>52.0</u>	<u>47.0</u>	<u>48.0</u>
Total	\$13,043.0	\$12,117.5	\$11,718.9	\$12,251.1
Change from Prior Year		-\$925.5	-\$398.6	\$532.2
Percent Change		-7.1%	-3.3%	4.5%

**TABLE 2**

**Summary of National Economic Indicators**  
**IHS Global Insight, Inc.**  
**May, 2009**  
**(\$ in Billions)**

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Nominal Gross Domestic Product	\$14,264.6	\$14,017.6	\$14,339.4	\$15,017.5
% Change	3.3%	-1.7%	2.3%	4.7%
Real Gross Domestic Product	\$11,652.0	\$11,294.9	\$11,458.7	\$11,846.8
% Change	1.1%	-3.1%	1.5%	3.4%
Consumer Prices (Percent Change)	3.8%	-1.2%	1.5%	2.3%
Personal Income	\$12,102.7	\$12,078.3	\$12,294.7	\$12,779.2
% Change	3.8%	-0.2%	1.8%	3.9%
Personal Consumption Expenditures	\$10,057.9	\$9,988.2	\$10,281.2	\$10,692.2
% Change	3.6%	-0.7%	2.9%	4.0%
Economic Profits	\$1,476.5	\$1,222.5	\$1,329.4	\$1,521.2
% Change	-10.1%	-17.2%	8.7%	14.4%
Unemployment Rate	5.8%	9.2%	10.1%	9.5%
Total Employment (Millions)	137.0	132.0	131.2	133.2
% Change	-0.4%	-3.7%	-0.6%	1.5%
Housing Starts (Millions)	0.903	0.535	0.884	1.294
% Change	-32.6%	-40.7%	65.0%	46.4%

**National Economic Forecast**

With the exception of the first half of 2008, when positive economic growth coincided with the payment of more than \$100 billion of personal tax rebates by the federal government, the U.S. economy has been contracting since the fourth quarter of 2007. The declines have been particularly steep in recent months, with real (inflation-adjusted) gross domestic product (GDP) falling by 6.3% and 6.1%, respectively, in the fourth quarter of 2008 and the first quarter of 2009. Since December, 2007, 5.7 million jobs have been lost nationwide. More than two-thirds of these job losses occurred in the last seven months. The U.S. seasonally adjusted unemployment rate has increased from less than 5% at the end of 2007 to 8.9% in April. As of March, Wisconsin's seasonally adjusted unemployment rate was 8.5%, and the unadjusted rate was 9.4%.

Global Insight's January forecast (which was used in preparing the previous revenue estimates) estimated that real GDP fell by 5.6% in the fourth quarter of 2008, and anticipated

another significant decline in the first quarter of this year (-5.4%) and a smaller decline in the second quarter. Low levels of growth were expected to resume in the second half of this year, and a stronger recovery was expected in 2010 and 2011.

The May forecast assumes that a similar pattern of decline and growth will occur, but overall economic activity will be at lower levels than estimated in January. Annualized real GDP growth over the remainder of 2009 is now estimated at -2.5% in the second quarter, 0.2% in the third quarter, and 0.7% in the fourth quarter. Last January's estimates were -1.8%, 0.5%, and 1.6%, respectively. Real GDP growth is estimated at 1.5% in 2010 and 3.4% in 2011, compared to estimated growth rates of 2.2% and 3.2% in the January forecast. It should be noted that even though the projected 2011 growth rate is slightly higher under the May forecast (3.4% compared to 3.2%), the estimated amount of real GDP in dollars is \$139 billion lower than in the January forecast, because of the reduced estimates for 2009 and 2010.

Similar trends can be seen in the estimates for other broad economic indicators. Nominal (current-dollar) GDP is now projected to fall by 1.7% in 2009, and then increase by 2.3% in 2010 and 4.7% in 2011. The January growth rates were -1.4%, 3.5%, and 4.8%, respectively. Personal income growth is now estimated at -0.2% in 2009, 1.8% in 2010, and 3.9% in 2011, compared to the January estimates of 0.8%, 2.5%, and 4.5%. In terms of specific sources of income, the May estimates for wage income are 1% to 2% lower than the January estimates, but the new estimates of business, rental, and investment income have been reduced more significantly from the January figures (4% to 5% decreases). This is consistent with the April income tax collections data, which shows stable withholding collections, but very large decreases in quarterly estimated payments and net payments with returns (remittances less refunds). It is also consistent with the estimates of corporate profits, which have been reduced significantly since January.

Personal consumption was down significantly in the fourth quarter of 2008, but showed a small increase in the first quarter of this year. The May estimates (in dollars) are higher than the January projections in 2009 and 2010, but lower in 2011. Consumption is projected to decline by 0.7% in 2009 and then increase by 2.9% in 2010 and 4.0% in 2011. Global Insight indicates that the sharp first-quarter decline in real GDP was primarily due to decreased investment by businesses and significant reductions in inventories, rather than falling consumption. Inventory-to-sales ratios are still high by historical standards, but the recent decreases will help set the stage for future output growth.

Global Insight expects employment to continue to decline through the remainder of this year and the first quarter of 2010. Net increases in employment are expected beginning in the second quarter of next year. However, it is anticipated that the peak level of employment seen in late 2007 will not be reached until the beginning of 2013. The seasonally adjusted unemployment rate is estimated at 9.2% in 2009, 10.1% in 2010, and 9.5% in 2011. Compared to the January forecast, the projected levels of employment and growth rates are lower in each year. The unemployment rate is about 1% higher in each year.

The housing sector is expected to continue exerting a drag on economic growth during the remainder of 2009. Housing starts are estimated at 535,000 this year, and sales of new and existing

homes are estimated at 4.8 million. These figures compare with starts of 2.1 million and sales of 8.4 million when the market was peaking in 2005. With improvements in affordability, due to recent price declines, low interest rates, and the federal tax credit for first-time home buyers, increases in housing starts are forecast beginning in the third quarter of this year and in 2010 and 2011. Sales of new and existing homes are also expected to begin increasing later this year. However, the housing recovery will be constrained by more restrictive lending practices, and the level of activity seen in 2005 is not expected to recur for at least 10 years. The current housing indicators are below Global Insight's January estimates.

Global Insight also prepared two alternative forecasts, each with an estimated probability of 20%. The optimistic scenario assumes that the monetary and fiscal policy efforts of the federal government and foreign central banks take effect sooner than under the baseline forecast. There is still a decrease in real GDP until the third quarter of this year, but after that, growth resumes more quickly. The pessimistic alternative assumes that the financial crisis worsens, credit remains tight, and housing and consumer spending decline further. Under this scenario, the recession is deeper and more protracted, particularly in 2010. Real GDP growth is estimated at -3.9% in 2009, -1.0% in 2010, and 2.7% in 2011, compared to the baseline estimates of -3.1%, 1.5%, and 3.4%, respectively.

### **Revised General Fund Tax Estimates**

*Individual Income Tax.* Individual income tax receipts are estimated at \$6,185 million in 2008-09, \$5,870 million in 2009-10, and \$6,080 million in 2010-11. The revised figures represent decreases relative to the previous projections of \$400 million in 2008-09, \$465 million in 2009-10, and \$517 million in 2010-11. These decreases total \$1,382 million and represent 86% of the three-year reduction in total taxes (-\$1,603 million) reported above.

In January, income tax collections for 2008-09 were estimated to decrease by 1.9% compared to collections in 2007-08, based on the economic forecast and taxable personal income growth at the time. The reestimate is based on year-to-date tax collections that are 8.3% below the collections total for the same period last year. The estimates for the 2009-11 biennium have also been decreased to reflect the estimated reduction in base year collections and lower levels of personal income. In January, Global Insight projected U.S. personal income would increase by 0.8% in 2009, 2.5% in 2010, and 4.5% in 2011, but the May forecast projects personal income to decrease by 0.2% in 2009 and increase by only 1.8% in 2010 and 3.9% in 2011.

*Sales Tax.* Through April, 2009, total year-to-date sales tax collections were 3.3% lower than in April, 2008. If the impact of the *Menasha Corporation* decision and other factors are accounted for, the adjusted year-to-date growth rate is -1.9%. Our estimate under Act 2, was for an annual reduction of 5.5% at the close of the 2008-09 fiscal year. At this time, based on year-to-date collections and an increased forecast of taxable consumption expenditures, we believe that sales tax revenue will be higher than the Act 2 estimates by \$96 million in 2008-09, \$66 million in 2009-10, and \$37 million in 2010-11. The revised estimates are \$4,130 million, \$4,055 million, and \$4,280 million, respectively. The upward revisions primarily reflect higher than anticipated year-to-date collections and a more optimistic forecast over the remainder of 2008-09. Slightly lower growth is

projected over the 2009-11 biennium, but the higher base year causes the estimates to be increased in all three years.

*Corporate Income and Franchise Tax.* Corporate income and franchise tax revenues are now projected to be \$615 million in 2008-09, \$650 million in 2009-10, and \$740 million in 2010-11. Compared to the previous estimates, the revised estimates represent decreased corporate income and franchise tax revenues of \$63 million in 2008-09, \$126 million in 2009-10, and \$93 million in 2010-11. Both sets of estimates include additional revenues from the combined reporting provisions in Act 2. The new estimates reflect year-to-date corporate income and franchise tax collections, which are 29.1% lower than in 2007-08. Similarly, corporate estimated payments have decreased 28.0%, compared to the same period last year.

The drop in collections mirrors the sharp decline in corporate earnings and business fixed investment in recent months. The Standard and Poor's stock index fell over 40% between the first quarter of 2008 and 2009. Business fixed investment dropped at an annual rate of 30% in the first quarter of 2009. Due to the significant reductions in business production and inventory since the fourth quarter of 2008, the economy may be approaching a point where meeting subsistence demand requires an increase in output. The forecast projects that corporate profits will begin to rebound in the fourth quarter 2009 and continue to increase throughout the forecast period. As a result, corporate income and franchise tax revenues are projected to increase in 2009-10 and 2010-11.

*Public Utility Taxes.* Compared to January's estimates, public utility taxes are estimated to be lower by \$6 million in 2008-09, and \$13 million in 2009-10 and 2010-11. The reductions are attributable to the private light, heat, and power company taxpayer group, which is subject to a gross receipts tax. Increases in electric rates due, in part, to the construction of new power production plants have been offset by large decreases in natural gas prices. Lower natural gas prices have affected gross receipts tax collections in two ways. First, consumers' natural gas rates are lower. Second, natural gas has increasingly been used as a power source for electricity generation, and lower natural gas prices have resulted in less dramatic electric rate increases than estimated in January and in ratepayer refunds in some instances due to fuel adjustment clause provisions in electric rates. Finally, the economic contraction is estimated to decrease commercial and industrial power consumption in 2009 and 2010.

*Insurance Premiums Tax.* Insurance premiums tax collections are projected to be \$140 million in 2008-09 and \$148 million in 2009-10 and 2010-11. These projections represent decreases from the previous estimates of \$30 million in 2008-09, \$31 million in 2009-10, and \$32 million in 2010-11. The new estimates primarily reflect premiums tax collections, which have declined significantly in recent months. Through April, insurance premiums tax collections are 11% lower than collections through April, 2008. The decline in premiums tax revenues reflects the decline in economic activity throughout the economy. Individuals are less likely to purchase insurance during economic downturns, while as businesses downsize they take actions to reduce insurance bills. For example, even though the cost of health insurance is expected to continue to rise, businesses can control some of the cost by switching to higher deductible, lower cost plans

with lower premiums. Insurance premium tax revenues are projected to increase somewhat as the economy rebounds.

*Miscellaneous Taxes.* Estimated revenues from miscellaneous taxes have been reduced by \$4 million in 2008-09 and by \$5 million in 2009-10 and 2010-11. The projected reduction in revenue is primarily due to a steeper than anticipated year-to-date decrease in real estate transfer fee collections of -31.6%, as well as a reduced forecast in housing indicators over the 2009-11 biennium. The estimates for the remaining miscellaneous taxes, municipal and circuit court-related fees, and the occupational tax on coal, have not been revised. Total miscellaneous tax revenues are estimated at \$52 million in 2008-09, \$47 million in 2009-10, and \$48 million in 2010-11.

*Other Taxes.* Estimated revenues from the estate tax, which is no longer being imposed, have been reduced by \$1 million in 2008-09 due to refunds in recent months. The estimates for the excise taxes on alcohol and tobacco have not been revised.

### **Impact on General Fund Balance**

Based upon the tax collection estimates of this analysis, the balance in the general fund at the end of the 2008-09 fiscal year is projected to be -\$189.0 million, and the net balance at the end of the 2009-11 biennium is estimated at -\$1,449.7 million. These general fund balance projections are based upon: (1) the provisions of 2009 AB 75, as modified, to date, by the Joint Committee on Finance; and (2) the current law tax collection estimates of this analysis.

AB 75, as introduced, projected a net balance of \$139.0 million at the end of the 2009-11 biennium. The \$139.0 million balance is decreased by \$1,588.7 million to -\$1,449.7 million. The \$1,588.7 million figure is the net result of the reduction in estimated tax collections (-\$1,603.2 million) and changes made, to date, by the Joint Committee on Finance that improve the balance (\$14.5 million).

The balance estimates do not take into consideration any revenue or appropriation modifications that may occur over the remainder of the Finance Committee's work on AB 75.

This office will continue to review the revenue and expenditure estimates used in AB 75, as well as tax collections data and new economic forecasts, and notify you and your colleagues of any further adjustments that may be necessary.

Sincerely,



Robert Wm. Lang  
Director

RWL/sas

cc: Members, Wisconsin Legislature